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CZAR RESOURCES LTD.
ANNUAL REPORT 1977

BOARD OF DIRECTORS

Robert W. Lamond
Calgary, Alberta

Gregory S. Fletcher
Calgary, Alberta

Ian B. McMurtrie
Calgary, Alberta

Rudolf Siegert
Munich, West Germany

OFFICERS

Robert W. Lamond
President & Chief
Executive Officer

Gregory S. Fletcher
Executive
Vice-President

Allan R. Twa
Corporate Secretary

KEY PERSONNEL

D. Harvey Bickell
Chief Engineer

Ian B. McMurtrie
Exploration Manager

Anna Wallace
Accountant

Les G. Broker
Manager
Czar Resources, Inc.

Kim P. Swyden
Chief Landman
Czar Resources, Inc.

HEAD OFFICE

1100, 550 - 6th Avenue South West
Calgary, Alberta T2P 0S2

U.S. OFFICE

2520 One Allen Center
Houston, Texas 77002

FIELD OFFICE

10142 - 100th Avenue
Fort St. John, British Columbia

LEGAL COUNSEL

Burnet Duckworth & Palmer
800 Royal Bank Building
335 - 8th Avenue South West
Calgary, Alberta

AUDITORS

Thorne Riddell & Co.
Suite #1400 - Bow Valley Square 2
205 - 5th Avenue South West
Calgary, Alberta

REGISTRAR & TRANSFER AGENTS

The Canada Trust Company
239 - 8th Avenue South West
Calgary, Alberta

WHOLLY-OWNED SUBSIDIARIES

Czar Resources, Inc.
Czar Developments Ltd.

STOCK LISTING

The Alberta Stock Exchange
#201, 500 - 4th Avenue South West
Calgary, Alberta
Trading Symbol - CZR

ANNUAL MEETING

The Annual Meeting of Shareholders of Czar Resources Ltd. will be held at 2 p.m., Friday, March 31, 1978, in the Glenview Room of the Calgary Convention Centre, 110 - 9th Avenue South East, Calgary, Alberta.

HIGHLIGHTS

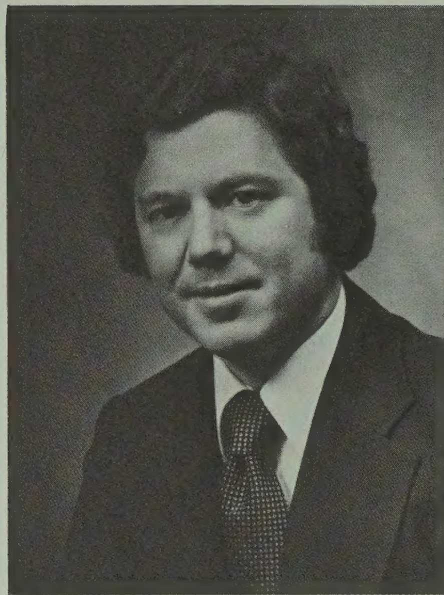
YEAR ENDED OCTOBER 31, 1977

FINANCIAL

	1977	1976
Total revenues	$ 2,083,285	$ 509,863
Working capital provided by operations (cash flow)	$ 1,679,906	$ 311,643
Cash flow per share	76¢	16.5¢
Net earnings	$ 995,389	$ 190,635
Earnings per share	45¢	10¢
Total assets	$11,809,580	$3,845,849
Shares issued	2,278,400	2,096,000
Return on shareholders capital	50%	17%

OPERATING

	1977	1976
RESERVES		
Net proven gas (BCF)	95.9	41.8
Net proven oil (bbls)	956,000	608,000
DRILLING		
Oil completions	7	11
Gas completions	35	11
Dry and abandoned	9	5
	51	27
LAND HOLDINGS		
CANADA		
Gross acres		
Alberta	118,960	63,191
British Columbia	108,468	38,164
UNITED STATES		
Louisiana	155	—

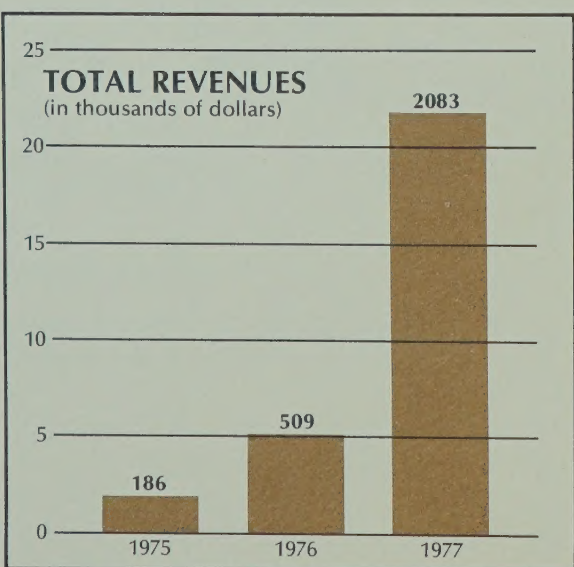


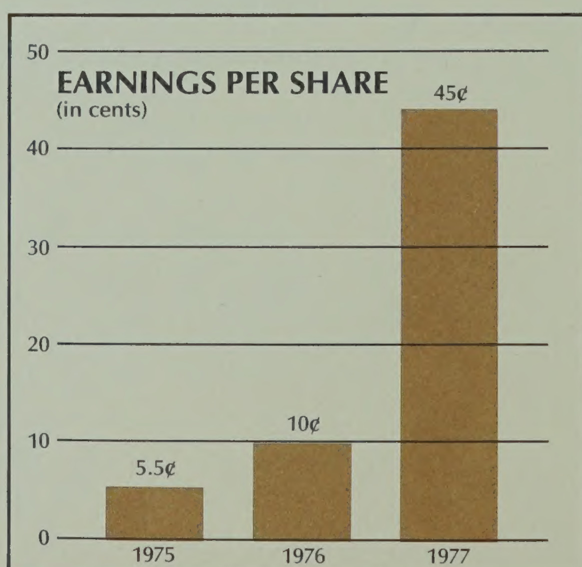
TO THE SHAREHOLDERS:

During 1977 Czar continued in its rapid growth of prior years and made significant advances in diversifying its exploration and financial bases.

Czar earned $995,389 or 45¢ per share in contrast with earnings of $190,635 or 10¢ per share during 1976. Cash flow increased from $311,643 or 16.5¢ per share in 1976 to $1,679,906 or 76¢ per share in 1977. Gross revenues increased to $2,083,285 of which production derived revenues, totalling $1,467,754, formed 70% of the total. This increasing revenue figure is compared with production derived revenue of $283,658 or 55% of gross revenues for 1976. Due to a larger reliance than in the past on bank financing, shareholder's return on equity was leveraged from 17% to 50%, but as a consequence the Company's working capital deficiency increased to $1.9 million. This working capital deficiency was reduced in part by a stock issue which was placed subsequent to the year end and raised $562,500. As compared to 1976, earnings, cash flow and gross revenues for 1977 increased by 432%, 439%, 309% respectively. These dramatic increases should be put into proper perspective when viewing Czar's overall growth pattern by noting that the four most significant producing properties in terms of reserves and ultimate cash flow to Czar are not yet on stream.

Czar doubled its exploration program during 1977 drilling 51 wells of which 35 were gas wells, 7 were oil wells and 9 were abandoned as dry holes. Although drilling activity doubled during the year, the Company maintained an enviable success rate of 82%. Significant discoveries were made at Medicine River and Blackie in Alberta and at Birch in British





Columbia. Additional drilling at Monias in British Columbia resulted in an extension of the pool limits into what may be the Company's largest single hydrocarbon reserve discovered to date.

The general oil industry climate improved markedly during the year. Gas and oil prices increased substantially and despite inadequate Alberta gas markets, drilling continued at a very high pace with drilling equipment being at a premium. The Company moved to stay abreast of this problem by contracting five drilling rigs on a continuing basis, giving it ample flexibility with which to conduct its exploration program. The solid operating base which Czar has established in British Columbia has been further expanded through land acquisition and exploratory drilling. British Columbia is still readily contracting natural gas and the Company's cash flow from this source continues to increase to the point that during 1977, revenue from natural gas sales in British Columbia accounted for approximately 80% of total revenues. As this source of revenue increases, the Company is continuing its efforts to establish gas reserves in Alberta for sale in the future.

In a move to further increase its exploration exposure and production base, the Company established an office in Houston, Texas staffed by capable individuals with considerable experience in the U.S. Gulf Coast area. Prior to establishing the Houston office, the Company participated in a dry hole in Montana and a potential oil well in Louisiana, however, with the addition of the Houston staff to the Company, we anticipate generating and drilling a number of quality geological prospects in the U.S. Gulf Coast area during 1978.

Czar's relationship with its West German financial partner advanced during the year. After two years of drilling and constructing production facilities, significant cash flows are being returned to investors in previous fund programs completing successfully this investment cycle. The resulting investor confidence is reflected in the success of two fund programs, which raised $18 million in Germany during 1977, for use exclusively by Czar. A new drilling arrangement has been negotiated with the West German group and a minimum of $10 million in drilling funds is anticipated from this source during 1978. In a move to diversify the Company's sources of exploration funds, Czar entered into a joint venture agreement with a Calgary based company which contributed $2 million to Czar's 1977 exploration program. This latter arrangement is of great value in developing continuing sources of financing and increasing Czar's local stockholder and financial base and is to be continued during 1978.

During the year Gregory S. Fletcher and Ian B. McMurtrie, both employees of the Company, were appointed directors of Czar Resources Ltd. and its subsidiaries. In addition, D. Harvey Bickell joined the staff as Chief Engineer of the Company. With the above appointments Czar now has capable, experienced personnel supervising all major aspects of the Company's operations and forming the nucleus of a dynamic young management team.

In April of 1977, the stock of the Company was split on a two for one basis and continued its impressive performance by climbing from $7.00 per share to $13.87 per share at the October 31, 1977 year end. This increase reflects the growth of the underlying assets of the Company and indicates in part a recognition of greatly improved earnings in 1977 and investor confidence for subsequent years.

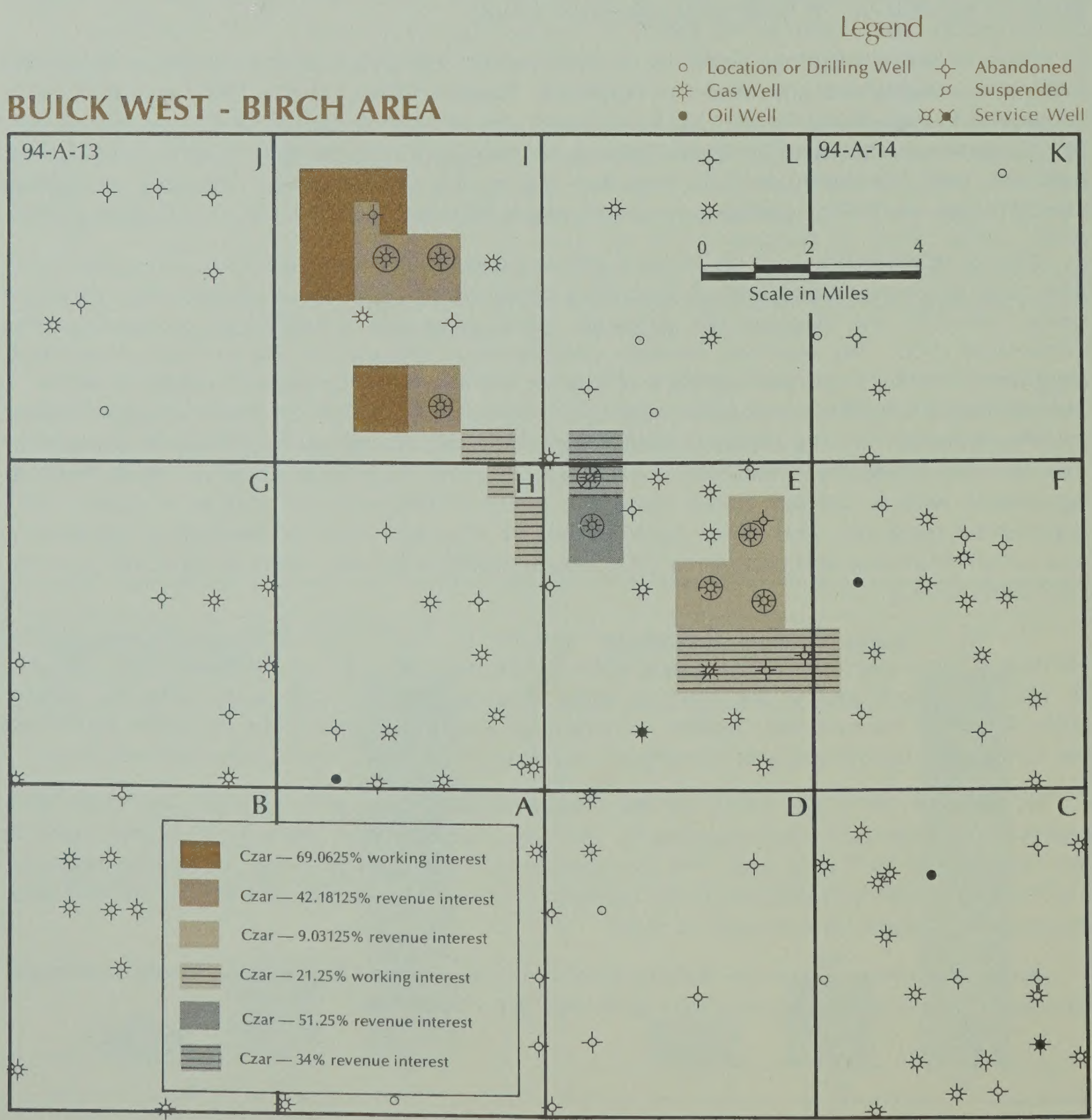
Application was made for listing on the Toronto Stock Exchange and we anticipate having our application approved during the first quarter of 1978.

BRITISH COLUMBIA

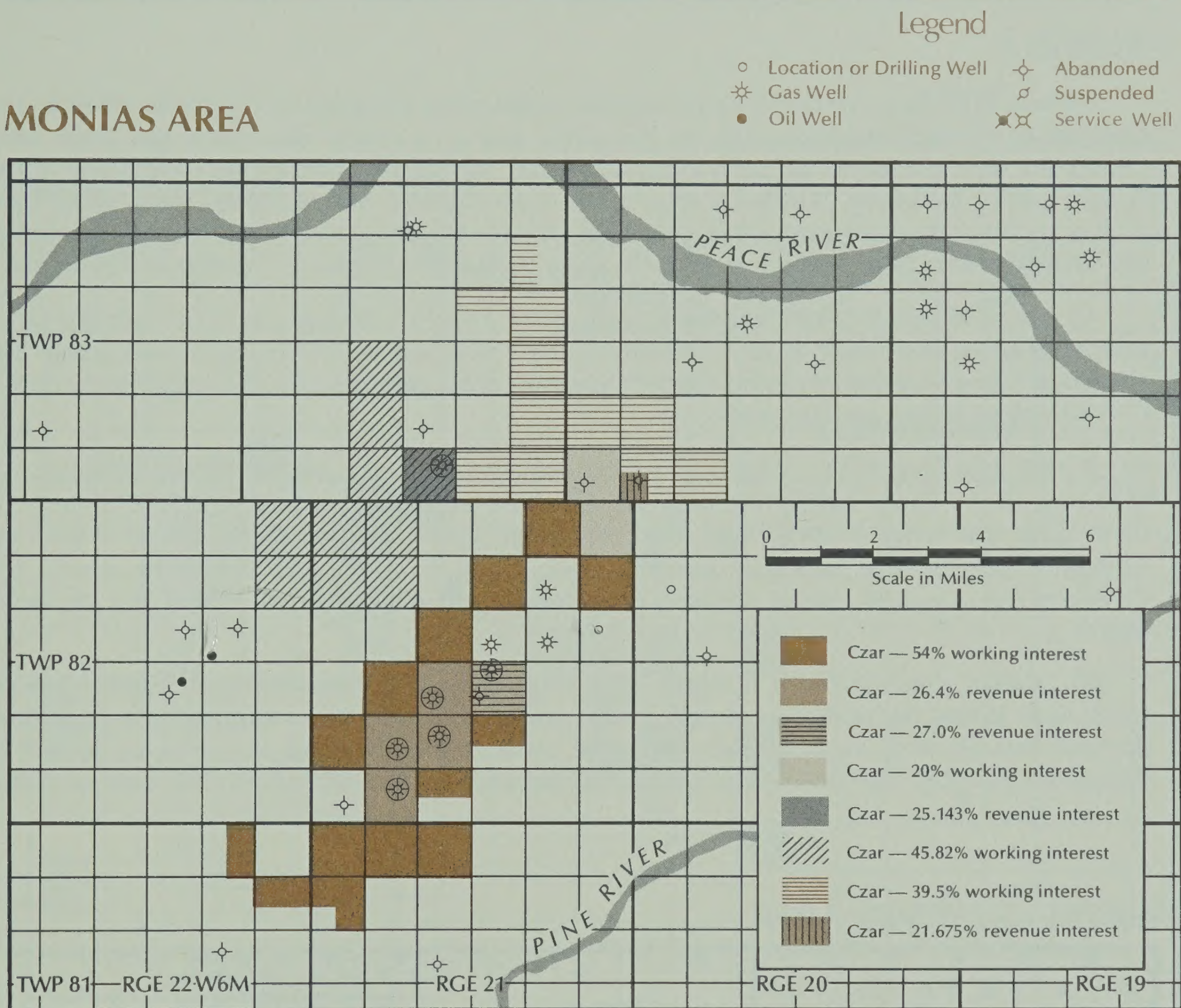
In British Columbia significant new gas discoveries were made by the Company at Blueberry, Buick West, Aitken Creek, Goldenrod, Flatrock and Birch. Development drilling delineated a large extension to the Monias Field and resulted in the completion of 2 gas wells at Cache Creek.

At Buick West, three Bluesky gas wells in which the Company has a 9.0% revenue interest were completed for rates of over 2 million cubic feet of gas per day. Two of these wells are already producing and a third well will be on stream shortly. At Flatrock, Czar drilled two Halfway gas wells, the better well, Czar et al Flatrock 10-18-85-15 W6M, testing over 5 million cubic feet of gas per day after completion. An early tie-in and additional drilling is anticipated for this area.

BUICK WEST - BIRCH AREA



MONIAS AREA



Czar completed a Triassic discovery well at Birch c-14-I, 94-A-13, and, with two successful follow up wells, expects to have gross production of over 7 million cubic feet of gas per day from this area by April of 1978. The Company has a 42.18% revenue interest in these wells and projects a monthly net cash flow of $95,000 from the properties.

The Monias Field, located 25 miles southwest of Fort St. John, was extended by three development gas wells drilled during the year. These wells, with over 100 feet of Halfway gas pay and deliverabilities ranging from 2 to 8 million cubic feet per day have established Monias as a substantial field. Total field reserves are in the 150 BCF range. Czar's net share of reserves totals 20 BCF and the Company projects net gas deliverability of 3.5 million cubic feet per day. Subsequent to the October 31, 1977 year end, the Company, as operator of the Monias Field, commenced construction of a 22 mile 8⅝" pipeline into this area and anticipates having the gas on stream by April 15, 1978.

A twin to our discovery well, c-16-L, 94-A-11, at Cache Creek was completed as a Coplin well with an initial potential of 700,000 cubic feet per day. This well is now on stream. To the north a follow-up well at d-37-L, 94-A-11 in which Czar has a 10% revenue interest tested over 2 million cubic feet of gas per day from the Coplin zone and 700,000 cubic feet of gas per day from over 50 feet of Halfway gas pay. This well is now being completed and should be on stream in the near future.

ALBERTA

During 1977 Czar conducted an extensive exploration program in Southern Alberta. The Company's primary emphasis was on gas plays and as a result, successful gas wells were drilled on new prospects at Lone Pine, Leahurst, Allingham, Three Hills, Medicine River, Sylvan Lake, Galloway, Linden, Wimborne and Sunset. In addition, two multi-zone development wells were completed at Hussar. Three oil wells were drilled as an extension to the North Twining field and single oil wells were drilled at Wimborne, Stettler and Pearce.

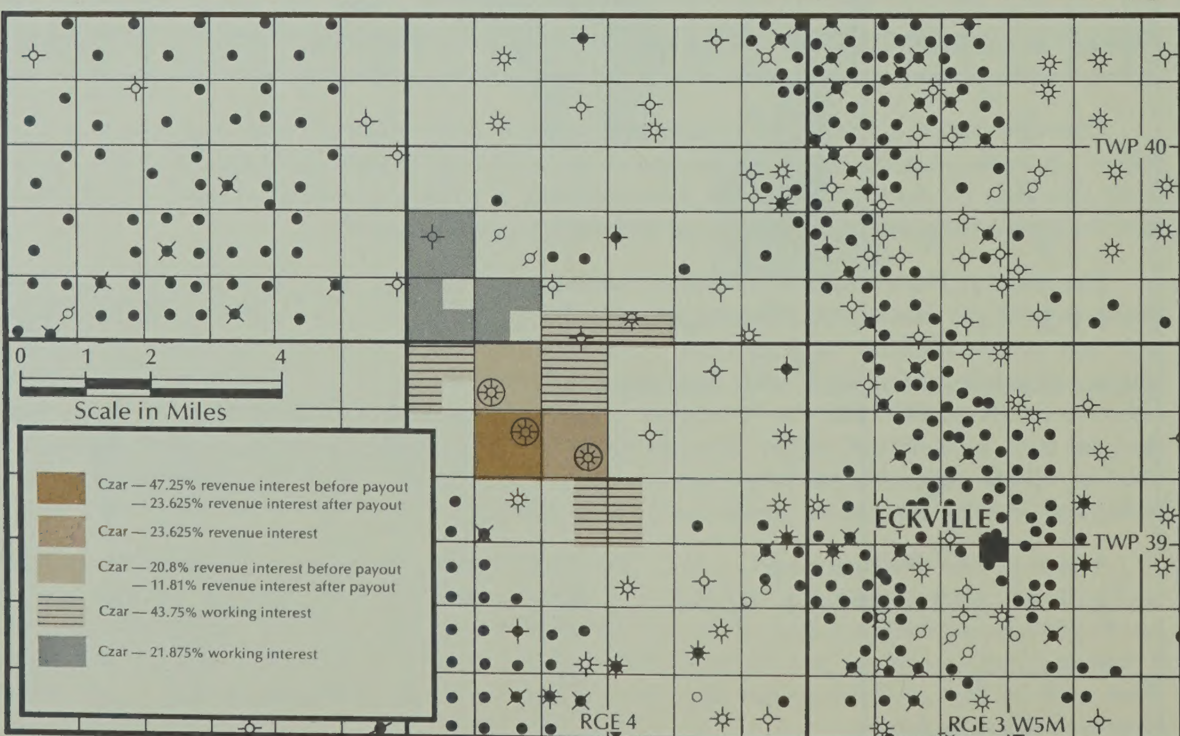
Of major importance in this year's exploratory effort in Alberta was Czar's emphasis on deeper plays in the Sylvan Lake - Crossfield areas. This highly productive Mississippian and Devonian trend was actively explored with exceptionally good results. Ten wells were drilled of which eight were cased as producers.

A new gas pool with a high condensate content, was discovered by the Company at Medicine River. Three wells with average pay of 20 feet were completed in the Glauconite zone. Czar estimates a reserve of over 50 billion cubic feet for this pool in which the Company has revenue interests ranging from 20.8% to 47.25% in the three wells. The Company has acquired similar interests in approximately 6000 acres off-setting the discovery well.

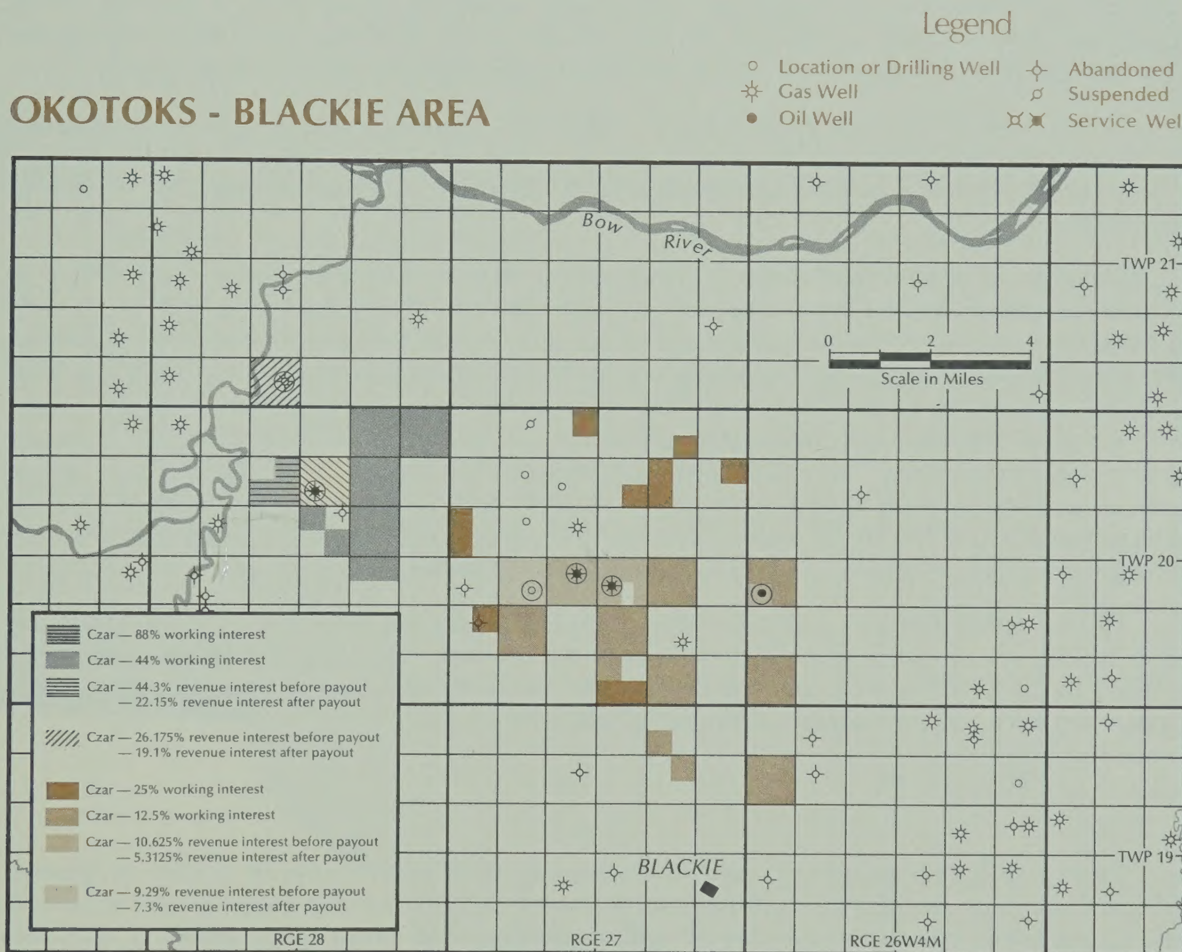
At Blackie, southeast of Calgary, the discovery well, Sabine Czar Numac Blackie 10-16-20-27 W4M, encountered 36 feet of gas pay in the Belly River Formation. In addition, the well flowed oil to surface from 45 feet of Turner Valley pay and encountered 36 feet of Wabamun gas pay. Two successful follow up wells have been drilled and the area promises

MEDICINE RIVER AREA

Legend
Location or Drilling Well
Gas Well
Oil Well
Abandoned
Suspended
Service Well



OKOTOKS - BLACKIE AREA



to be one of continuing activity for some time to come. Czar owns various interests ranging from 10.6% to 25% in 4840 gross acres in the immediate area. Nearby, to the west, Czar also has an extensive acreage and option land spread on a similar multi-horizon play on which two successes were completed after the year end. At least two additional wells are to commence immediately in each of these areas.

In other areas, Czar drilled an exceptional Glauconite oil well in Wimborne. The well's initial production was gauged at 550 bbls per day and it has been producing at an allowable restricted rate of 1500 bbls per month since July, 1977. Czar has a 32.53% revenue interest in this well. A close-in development well, Czar et al SyLake 11-7-37-2 W5M, encountered 20 feet of Pekisko gas in the Sylvan Lake area and flowed 1.2 million cubic feet of gas per day with a tubing pressure of 1000 psi on completion. As this well is obviously connected to a nearby, currently producing Pekisko pool, an early connection is anticipated. A continuation of our

Mississippian exploratory program northeast of Calgary resulted in shallow gas wells at Allingham, Wimborne and Linden as well as three development oil wells at Twining North. These oil wells are now on stream through a tank battery and the considerable associated solution gas from this pool is being marketed through a recently completed gas plant.

At Leahurst, three multi-zone gas wells were drilled, with production being established in the Viking, Glauconite and Ostracod zones. A fourth well in this area was completed as an Ostracod oil well and is currently producing 20 bbls/day. Additional wells will be drilled during 1978.

In order to establish additional deliverability, two development wells were drilled at Hussar resulting in dual zone completions with deliverabilities from the Bow Island and Glauconite zones of 2.5 million cubic feet of gas per day and 0.9 million cubic feet of gas per day respectively. These wells, in conjunction with wells drilled earlier by the Company, have established reserves of 56 billion cubic feet of gas underlying lands operated by Czar. As the acreage is subject to a gas purchase contract the Company, as operator of a four company group, has commenced construction of a gas plant with a capacity of 9 million cubic feet of gas per day and projects an onstream date of April 1, 1978. Gross production from the Hussar properties is expected to be approximately 7.25 million cubic feet of gas per day with the Company's revenue interest varying from 10.625% to 25.00% in the five wells.

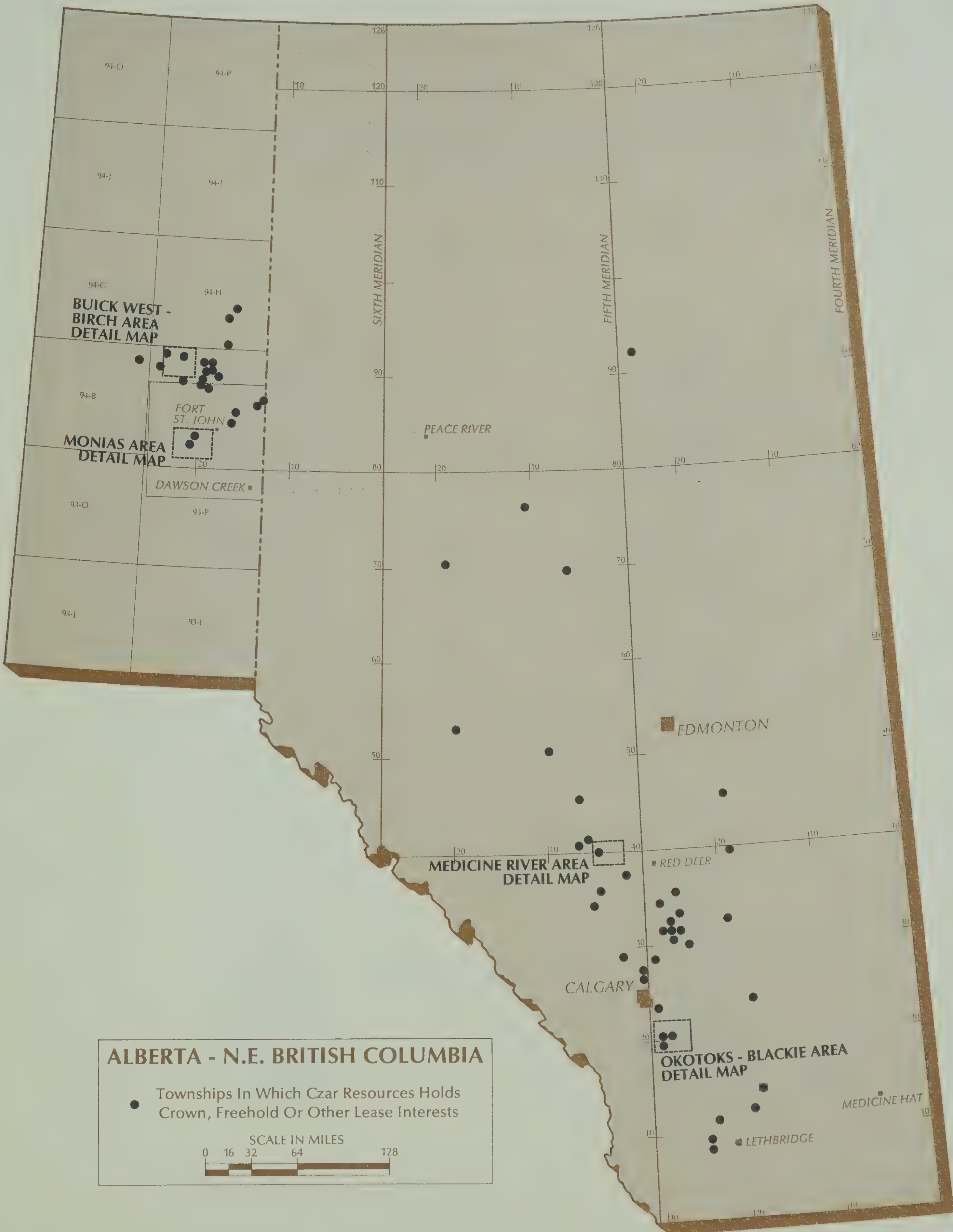
The Company drilled a well on a large spread of acreage at Pearce, located 15 miles west of Lethbridge, and cased same as a Mississippian oil well. Mechanical problems precluded drilling this well to its projected total depth but the well is producing intermittently at high rates from a fractured reservoir of indeterminate areal extent.

During 1978 Czar expects to continue operating in its prime areas of activity in Alberta, British Columbia, and the U.S. Gulf Coast, however, as our staff and financial ability permits the Company is constantly looking at drilling programs in other areas where a favorable risk-reward ratio can be obtained. The steadily increasing volume of work associated with our expanding exploration program is being handled smoothly by our Accounting, Land, Engineering and Geological Department staff and I would like to thank them all sincerely on behalf of the shareholders for contributing so much towards the Company's success.

I am pleased to report on the Company's progress during the past 12 months and am confident that continued rapid growth will be seen by shareholders in the year ahead.

PRESENTED ON BEHALF OF THE
BOARD OF DIRECTORS
MARCH, 1978

R. W. Lamond
President



ALBERTA - N.E. BRITISH COLUMBIA
Townships In Which Czar Resources Holds Crown, Freehold Or Other Lease Interests
SCALE IN MILES
0 16 32 64 128
BUICK WEST - BIRCH AREA DETAIL MAP
MONIAS AREA DETAIL MAP
MEDICINE RIVER AREA DETAIL MAP
OKOTOKS - BLACKIE AREA DETAIL MAP
FORT ST. JOHN
DAWSON CREEK
PEACE RIVER
EDMONTON
RED DEER
CALGARY
MEDICINE HAT
LETHBRIDGE
SIXTH MERIDIAN
FIFTH MERIDIAN
FOURTH MERIDIAN
94-O
94-P
94-I
94-G
94-H
94-B
93-O
93-P
93-J
93-I

CONSOLIDATED BALANCE SHEET

AS AT OCTOBER 31, 1977

ASSETS

	1977	1976
CURRENT ASSETS		
Cash and term deposits	$ —	$ 364,414
Accounts receivable — trade	2,254,589	1,862,034
— drilling program funds (note 2)	3,762,408	—
Inventory of supplies, at lower of cost and net realizable value	60,868	12,307
	6,077,865	2,238,755
LONG-TERM RECEIVABLE (note 2)		
— on property dispositions	22,930,330	7,445,138
— deferred revenue thereon	(22,930,330)	(7,445,138)
	—	—
FIXED ASSETS (notes 1 and 2)		
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	5,916,692	1,631,674
Accumulated depletion and depreciation	(184,977)	(24,580)
	5,731,715	1,607,094
	$11,809,580	$3,845,849

Approved by the Board:

Director

Director

LIABILITIES

	1977	1976
CURRENT LIABILITIES		
Bank indebtedness, secured	$ 1,288,024	$ —
Accounts payable and accrued liabilities	5,264,463	2,271,191
Drilling advances	1,429,451	108,722
	7,981,938	2,379,913
DEFERRED INCOME TAXES (note 1)	639,541	115,421

SHAREHOLDERS' EQUITY

	1977	1976
CAPITAL STOCK (note 3)		
Authorized		
5,000,000 common shares without nominal or par value		
Issued		
2,278,400 (1976 — 2,096,000) common shares	1,980,875	1,138,678
RETAINED EARNINGS	1,207,226	211,837
	3,188,101	1,350,515
	$11,809,580	$3,845,849

CONSOLIDATED STATEMENT OF EARNINGS

YEAR ENDED OCTOBER 31, 1977

	1977	1976
REVENUE		
Production (note 2)	$1,054,267	$201,658
Net revenue interests from property dispositions (note 2)	413,487	82,600
Management fees (note 2)	605,018	189,830
Interest on term deposits	10,513	35,775
	2,083,285	509,863
EXPENSES		
Production	113,675	30,775
General and administrative	289,704	167,445
Depletion and depreciation	160,397	21,908
	563,776	220,128
Earnings before income taxes	1,519,509	289,735
PROVISION FOR DEFERRED INCOME TAXES	524,120	99,100
NET EARNINGS	$ 995,389	$190,635
EARNINGS PER SHARE (note 4)		
Basic earnings per share	$ .45	$ .10

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

YEAR ENDED OCTOBER 31, 1977

	1977	1976
RETAINED EARNINGS AT BEGINNING OF YEAR	$ 211,837	$ 21,202
Net earnings	995,389	190,635
RETAINED EARNINGS AT END OF YEAR	$1,207,226	$211,837

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED OCTOBER 31, 1977

	1977	1976
FUNDS OBTAINED FROM		
Operations		
Net earnings	$ 995,389	$ 190,635
Items not requiring funds	684,517	121,008
	1,679,906	311,643
Issue of common shares for cash, net of share issue expenses (note 3)	842,197	529,533
	2,522,103	841,176
FUNDS APPLIED TO		
Fixed assets, net (notes 1 and 2)	4,285,018	1,344,609
DECREASE IN WORKING CAPITAL POSITION	(1,762,915)	(503,433)
Working capital (deficiency) at beginning of year	(141,158)	349,968
WORKING CAPITAL DEFICIENCY AT END OF YEAR, as previously reported	—	(153,465)
Reclassification of inventory	—	12,307
WORKING CAPITAL DEFICIENCY AT END OF YEAR	$(1,904,073)	$(141,158)

AUDITORS' REPORT

To the Shareholders of
Czar Resources Ltd.

We have examined the consolidated balance sheet of Czar Resources Ltd. as at October 31, 1977 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at October 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
January 25, 1978

Thorne Riddell & Co.
Chartered Accountants

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED OCTOBER 31, 1977

NOTE 1 ACCOUNTING POLICIES

a) **Principles of Consolidation**

The consolidated financial statements include the accounts of Czar Resources Ltd. and its wholly-owned subsidiaries, Czar Developments Ltd. and Czar Resources, Inc.

b) **Oil and Gas Operations**

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas and related reserves are capitalized. Costs include land acquisition costs, geological and geophysical expense, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, and related overhead expenses. Such costs are depleted using the unit of production method based upon estimated proven developed reserves. In calculating depletion, natural gas reserves are converted to equivalent barrels of crude oil based on the relative net sales value of each product.

Reference is made to note 2.

c) **Depreciation**

Depreciation of petroleum and natural gas production equipment and related facilities is provided on the unit of production method based on estimated proven developed reserves. Depreciation of other equipment is provided on a straight-line basis at rates which are estimated to amortize the cost of the assets over their useful lives.

d) **Income Taxes**

The Company follows the tax allocation method of accounting under which the income tax provision is based on the earnings reported in its accounts. Under this method the Company provides for deferred income taxes to the extent that income taxes otherwise payable are eliminated by claiming exploration and development costs and capital cost allowances in excess of the related depletion and depreciation provisions reflected in its accounts.

NOTE 2 DRILLING PROGRAM AGREEMENTS

The Company has entered into agreements with five limited partnerships ("drilling program funds") under which the drilling program funds have the rights to acquire a working interest in substantially all of the Company's undeveloped properties, on a project-by-project basis. Subsequent to the exercise of such rights and payment of the initial consideration, additional payments made to the Company are to be derived from future net revenues of wells drilled pursuant to the agreements. Additional payments on account of the acquisition amounts and interest thereon made to the Company range from a

twenty percent to twenty-five percent net revenue interest in the wells drilled pursuant to each fund agreement and are therefore dependent upon successful commercial production from such wells. The drilling program funds pay for all geological and intangible costs plus a management fee. The Company is responsible for well completion costs.

Under the Company's accounting policies, payments made by the Company under these agreements are recorded as additions to fixed assets, and management fees charged by the Company are credited to earnings. Amounts to be received on disposition of properties pursuant to the net revenue interests held by the Company have been deferred and will be included in revenue on receipt of the applicable proceeds.

NOTE 3 CAPITAL STOCK

a) Changes in the Company's capital stock for the year ended October 31, 1977 were as follows:

	Number of Shares	Consideration
Balance, October 31, 1976 — see c) below	2,142,500	$1,138,678
Shares issued for cash, less applicable share issue expenses of $47,553	121,500	821,697
Shares issued for cash pursuant to option to purchase common share agreements	14,400	20,500
	2,278,400	$1,980,875

b) The Company has granted options to purchase common shares of the Company to certain employees and a consultant retained by the Company. At October 31, 1977, there were outstanding options to purchase 56,500 common shares which are exercisable from time to time to June, 1980 at prices ranging from $.75 to $9.00 per share.

Changes during the year ended October 31, 1977 in the number of optioned shares were as follows:

Outstanding at October 31, 1976, as adjusted pursuant to a 2 for 1 stock split	52,000
Options granted	18,900
Options exercised	(14,400)
Outstanding at October 31, 1977	56,500

c) During the year, 1,094,500 common shares were issued pursuant to a 2 for 1 stock split.

d) The authorized capital has been increased to 5,000,000 common shares without nominal or par value which may be issued for a maximum consideration of $5,000,000.

e) Reference is made to note 6 — Subsequent Events.

NOTE 4 EARNINGS PER SHARE

Basic earnings per share have been computed using the weighted average number of shares outstanding during the year. The earnings per share for the year 1976 have been restated to reflect the stock split referred to in note 3 c).

NOTE 5 STATUTORY INFORMATION

During the year the Company paid remuneration of $175,450 to its senior officers (including the five highest paid employees). The Company paid no remuneration to its three directors in their capacity as directors during the year. Two of the directors are also officers of the Company.

NOTE 6 SUBSEQUENT EVENTS

Subsequent to October 31, 1977, the Company issued 50,000 common shares for a net cash consideration of $562,500. In addition 15,000 common shares were issued pursuant to the terms of option to purchase common share agreements for cash in the amount of $17,100.

CZAR RESOURCES LTD.

ANNUAL REPORT 1977

QUAD-M GRAPHIC
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LITHOGRAPHED IN CANAD
BY McARA PRINTING LTD.